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Corporate Social Responsibility – Analysing Social and Financial Performance The Case of Romania

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Abstract:

Our paper emphasizes the strategic importance of CSR both for companies and society as well. A comprehensive literature review reflects the challenges mainly associated with two different approaches: CSR as a profitable business practice that consolidates a good corporate image, or CSR as an inefficient way of using corporate resources, negatively correlated with financial performance. Our paper brings theoretical and practical evidence proving that CSR improves the business commercial and financial performance; certain correlations should be established between social and financial indicators. As a case study, we analyze an international company on the Romanian market that has increased its business performance by adopting different CSR measures.

Keywords: *Corporate Social Responsibility (CSR); Social Performance; Financial Performance; Intangible Assets*

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1. Argument

Defined by the European Multistakeholder Forum on CSR as “a concept whereby companies integrate social and environmental concerns in their business operations and in their interaction with their stakeholders on a voluntary basis” (EMFCSR, 2004), corporate social responsibility has become nowadays one of the main challenges for companies around the world. The main idea behind the concept of CSR is “The Triple Bottom Line” – “Profit, People, Planet”: companies harmonize their efforts in order to be economically viable, socially responsible and environmentally sound (Elkington, 1994).

The debates on corporate social responsibility show that there is no unique approach when considering the appropriateness of assuming extended social responsibilities by companies. The vast majority of research on the topic emphasizes a positive correlation between corporate social and financial performance, as long as businesses do not forget the main purpose of their activity, which is profit maximization, and governments keep their roles in dealing with social issues (Iamandi, 2007).

The present paper aims to analyse, for the first time, the social and financial performance of a company operating on the Romanian business environment, in order to provide an extensive example for the above mentioned market.

2. CSR literature review

The purpose of this analytical endeavour is to prove that corporate social responsibility is far more than a mere philosophical concept, lacking consistency and practical applicability, but rather an effective mean to support the financial objectives of the company in the medium and long term. When CSR is thought of as a long-term corporate action plan, both society and the initiating companies win in social as well as in economic terms.

2.1. Corporate advantages of involving in socially responsible actions

Although corporate social responsibility can be viewed from both an ethical or pragmatic perspective, the business world prefers the *pragmatic approach of CSR*. Adopting a CSR policy has primarily two positive effects: on one hand, it supports the survival of the company in compliance with the new social requirements, and, on the other hand, if properly used, can attract that knowledge that hardly could be obtained without the involvement and cooperation of all stakeholders. A well managed CSR policy can offer the initiating company a valid competitive advantage.

Companies initiate a CSR policy with the objectives of maximizing global opportunities, improving relations with all stakeholder groups, increasing brand value, consolidating the business for the long term and reducing associated risks, starting from the assumption that the consumer is willing to pay more for a company’s social responsibility and that society will reward socially responsible companies. Another motivation for social involvement, besides strict economic gains, is the support for “value based management”; in this case, managers act to promote the values shared in the organization, including moral values, pursuing two main effects: the improvement of the company's long term brand image and reputation, by associating performance with ethical behaviour, and the creation and reinforcement of group sinergies inside the company (Popa, Filip, 1999).

A number of companies with good social and environmental records indicate that these activities can result in better performance and can generate more profits and growth. The economic impact of corporate social responsibility can be broken down into direct and indirect effects. *Positive direct results* may, for example, derive from a better working environment, which leads to a more committed and productive workforce or from more efficient use of natural resources. In addition, *indirect effects* result from the growing attention of consumers and investors, which will increase corporate opportunities on the markets. Inversely, there can sometimes be a *negative impact* on a company's reputation due to criticism of business practices; this can affect core assets of a company, such as its brands and image.

Financial institutions are making increasing use of social and environmental checklists to evaluate the risks of loans to, and investments in companies. Similarly, being recognised as a socially responsible enterprise, for example, through listing in an ethical stock market index (Dow Jones Sustainability Index, FTSE4Good, Domini Social Index 400 etc.), can support the rating of a company and therefore entails concrete financial advantages (European Commission, 2001).

Briefly emphasized, the benefits of a CSR policy for the initiating company are:

- obtaining a "social license to operate" from all stakeholders rather than just shareholders;
- harmonizing business practices with the expectations of all stakeholder groups;
- achieving sustainable competitiveness: improving corporate image, reputation and brand, improving customer loyalty and corporate sales, improving productivity and product quality, improving financial performance;
- creating new business opportunities and competitive advantages;
- increasing possibilities for the recruitment and retention of highly talented employees;
- attracting and retaining quality investors and business partners by increasing shareholder value, reducing stock variability and cost of capital, improving access to socially responsible investment funds, reducing risks by adopting best practices;
- cooperation with local communities and avoiding PR crises;
- obtaining state support and avoiding stricter regulations;
- building political capital.

Generally it is assumed that socially responsible companies will have above average financial results (Kroll, 2001), because a company's capability to successfully manage social and environmental aspects is a credible proof of a highly qualitative management and it contributes to minimizing risks by predicting and avoiding crises that could affect corporate reputation and cause dramatic drops in share prices (European Commission, 2001). This positive correlation between CSR and financial performance – represented by the share prices – is empirically supported by the examples of multinational American, European and Asian companies (Hill, Ainscough, Shank, Manullang, 2007).

2.2. The relationship between corporate social and financial performance

Empirical studies have shown *a positive correlation between the social performance of a company and its financial performance*, and that social involvement brings several benefits that offset and even "outrun" the costs.

Furthermore, current literature considers that *there is a direct and reciprocal causal link between a company's social responsibility and its profitability*: a socially responsible company will be better perceived by the public and will earn substantial profits; similarly, a financially well performing company will afford to promote and invest in a socially responsible behaviour, which will cause future prosperity. The connection between profitability and CSR can be seen on an ascending spiral, the so called "virtuous circle", demonstrated by the experience of multinational companies involved in social and environmental projects.

An exact evaluation and measurement of the positive impact a CSR policy has on financial results is difficult to achieve and there is no academic consensus yet on the means and methods for such an effort. Thus, although most of the research points to the conclusion that a positive correlation exists between social and financial performance, not all researchers in the field support this statement, with some results even contradicting it.

In order to obtain the bigger picture on the way authors have described the relationship between social performance (SP) and financial performance (FP) (and, in particular, *the causal link and the type of correlation between SP and FP*), we will synthetically present the conclusions of a research paper (Salzmann, Ionescu – Somers, Steger, 2005), based on previous analysis (Preston, O'Bannon, 1997) (See *Table 1: Theoretical synthesis of possible correlations between SP and FP*).

Authors have identified, in the theoretical framework described in Table 1, positive, negative or no correlations between SP and FP and different causal links between the two. Although the majority of the studies have shown positive correlations between SP and FP, this conclusion is not generally accepted and many aspects are still to be clarified, especially concerning the methods of research and analysis.

The results of the last 30 years considering the relationships between social and financial performance are different and often contradicting. This is why reaching an academic consensus is of the outmost necessity in order to make corporate social responsibility a globally profitable business strategy.

Among the causes of contradicting results in the field we can list (Salzmann, Ionescu – Somers, Steger, 2005):

- methodological deficiencies (inadequate measurement of social indicators, no empirical testing for concepts and definitions, not testing the correlations between the various variables, inadequate sampling, low data availability, inconsistency in measuring financial indicators etc);
- complexity and large variety of social and environmental aspects, with different effects across industries and countries;
- general focus on cross-industry U.S. samples, ignoring intra-industrial studies or other regions (e.g., Europe), making a comparative international study almost impossible;
- specific corporate combinations of SP-FP factors, that impedes meaningful comparisons;

- not properly considering certain factors, such as company size, risk exposure, sector / industry, context of the analysis;
- confusion on the right way of implementing and measuring CSR, considering the large variety of CSR definitions available in the literature (Godfrey, Hatch, 2007).

3. Data and Methodology

3.1. BRD – Groupe Société Générale (Romanian Development Bank)

From its total financial assets perspective, BRD ranks number two in the top of Romanian banks. Having a 6 billion Euro capitalization, at the end of June 2007, BRD holds the first position within the financial societies and the second position within all the companies listed on Bucharest Stock Exchange.

BRD is a known presence in all Romanian regions through its network that comprises more than 600 agencies. In June 2007, BRD counted 2.2 million active clients, either individual or corporate.

The main shareholder of BRD is Société Générale, one of the largest banking groups in the Euro area, whose services are being used by more than 22.5 million clients worldwide[5].

BRD is an important community actor, with various activities during the past years such as social, cultural, artistic patronage and sport partnerships. The bank approaches its implication in the local community in collaboration with some foundations, non-profit organizations, public institutions or sport federations[6].

3.2. Measuring BRD's social performance

In order to quantify BRD's social performance, we considered a set of social activities (more than 200) that the company conducted during the last seven years (2001 – 2007) and we rated them according to an Index (SINDEX) that we proposed. The composite index measuring BRD's social responsibility was developed considering three main factors: part of the methodology proposed by KLD Research & Analytics[7]; the Romanian economic, political, social and cultural environment; the corporate culture of BRD.

KLD Research & Analytics, Inc. is the leading authority on social research and indexes for institutional investors. Today, 33 of the top 50 institutional money managers worldwide use KLD's research to integrate environmental, social and governance factors into their investment decisions. KLD rates the social, environmental and governance performance of companies using a proprietary framework of positive and negative indicators. Companies are rated in seven major qualitative issue areas: Environment, Community, Corporate Governance, Diversity, Employee Relations, Human Rights, Product Quality and Safety. Analysts assign Strengths and Concerns associated with these issues, providing a social and environmental profile of companies.

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[5] http://www.brd.ro/banca/
[6] http://www.brd.ro/banca/comunicare/responsabilitate-sociala/
[7] http://www.kld.com/research/socrates/index.html

Considering the data availability and the characteristics of national and corporate culture, we determined a specific composite index in order to measure BRD's social responsibility (not rated by KLD). Thus, in order to analyze the social accountability of BRD, we focused on only four main types of criteria (*Community*, *Diversity*, *Employee Relations* and *Reporting*) and we assigned them different weights according to the national and corporate culture considered. We also determined specific indicators for each criteria and allotted them weights in order to be able to quantify each corporate social action (See *Table 2: Criteria for measuring CSR of BRD*).

Finally, the methodology for quantifying the social performance of BRD consisted in screening and scoring each social action to all the pre-established indicators in order to obtain specific values to be compared with financial indicators. For determining a social value for each trimester we allotted different weights to each responsible action according to its relative importance in the trimester considered. The data used in order to quantify the social performance of BRD is represented by these quarterly composite social values[8] (See *Graph 1: SINDEX*).

3.3. Measuring BRD's financial performance

The financial performance is typically assessed both by accounting and market-based measures. Due to the fact that accounting ratios illustrate only historical aspects of firms' performance, we used market performance measures (common stock returns) considered to be forward looking and representing the investors' evaluation of the ability of a firm to generate future economic earnings. The use of market measures suggests that an investor's valuation of corporate performance is a proper performance measure. Therefore we assessed BRD's financial performance using quarterly stock returns since its first trading day on Bucharest Stock Exchange (See *Graph 2: BRD's price evolution*). The data was gathered from REUTERS and covers the 2001 – 2007 financial years. The returns were computed on a quarterly basis, from data recorded on first Wednesday of January, April, July and October. In case the company was not listed or the markets were closed on Wednesday, we used data for the previous or subsequent days[9].

3.4. Granger causality

In order to detect and examine causal relation between social and financial performance we applied Granger causality tests[10]. The Granger causality test was developed as a more efficient approach as compared to the basic correlation tool, which does not necessarily imply causation between correlated variables in any significant sense of the word. The Granger test addresses the issue of whether the current value of a variable y (y_t) can be explained by past values of the same variable (y_{t-k}) and then whether adding lagged values of another variable x (x_{t-k}) improves the explanation of y_t. As such,

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[8] For more detailed information regarding the methodology and the social actions considered, please contact the authors.

[9] Given the fact that such data lack was infrequent in our set of data, we do not consider it as systematically affecting our results.

[10] Granger causality was developed in 1960s (Granger, 1969) and has been widely used since then. See for example (Horobeț, Chiciudean, Dumitrescu, 2006).

the variable *y* is said to be Granger-caused by *x* if the coefficients on the lagged values of *x* are found to be statistically significant.

The general form of a Granger test is the following:

$$y_t = \alpha_0 + \alpha_1 y_{t-1} + \alpha_2 y_{t-2} + \ldots + \alpha_k y_{t-k} + \beta_1 x_{t-1} + \beta_2 x_{t-2} + \ldots + \beta_k x_{t-k} + \varepsilon_t \quad (1)$$

$$x_t = a_0 + a_1 x_{t-1} + a_2 x_{t-2} + \ldots + a_k x_{t-k} + b_1 y_{t-1} + b_2 y_{t-2} + \ldots + b_k y_{t-k} + u_t \quad (2)$$

where α_0 and a_0 are the constants, and ε_t and u_t are residuals. It is worth mentioning that the statement "*x* Granger causes *y*" does not necessarily imply that *y* should be seen as the effect or results of *x*, as the Granger test measures only precedence and information content on variable *y*, and does not indicate causality in the common sense of the word. The only significant piece of information the Granger test reveals is if whether the *x* variable helps in a better prediction of the *y* variable.

4. Results

The application of Granger causality assumes that the analyzed time series are covariance stationary. Thus, the series were tested for stationarity and according to *Unit root test* we noticed that the BRD's returns series is stationary (RAND_BRD) and the BRD's social index series is stationary only at the second difference (SINDEX_BRD_2).

For our research purposes, the *y* variable was represented by SINDEX_BRD_2 and the *x* variable was represented by RAND_BRD (See *Table 3: BRD's social and financial performance*).

The autoregressive models estimated for the two variables[11], using EViews, indicated that 2 lags are significant for SINDEX_BRD_2 and RAND_BRD. As a result, we performed Granger tests and the model's form, illustrated for the relationship between social and financial performance, follows:

$$SINDEX\_BRD\_2_t = \alpha_0 + \alpha_1 SINDEX\_BRD\_2_{t-1} + \alpha_2 SINDEX\_BRD\_2_{t-2} + \beta_1 RAND\_BRD_{t-1} + \beta_2 RAND\_BRD_{t-2} + \varepsilon_t \quad (3)$$

$$RAND\_BRD_t = a_0 + a_1 RAND\_BRD_{t-1} + a_2 RAND\_BRD_{t-2} + b_1 SINDEX\_BRD\_2_{t-1} + b_2 SINDEX\_BRD\_2_{t-2} + u_t \quad (4)$$

Our results with respect to Granger tests show that RAND_BRD has an explanatory power on SINDEX_BRD_2 at 2 lags and, at the same time, SINDEX_BRD_2 Granger causes RAND_BRD at 2 lags (See *Table 4: Pairwise Granger Causality Tests at 2 lags*). One may observe that the results are statistically significant and taking into consideration that the data frequency was quarterly and the tests were performed at 2 lags, a relationship could be established between social activities and financial performance, with a half year lag. In summary, corporate social responsibility and financial performance appear to be related when using a Granger causality approach.

5. Conclusions and future research

Assessing the debate whether corporate social responsibility has an impact on shareholder value or vice-versa, our research stresses the interdependence between the

[11] Results for 99% level of confidence.

above mentioned variables. Being the first synthetic analysis ever made for the Romanian market, we adhere to the vast majority of the studies stating that a clear cut relation exists in time between contributions to corporate social responsibility and shareholders' returns.

The novative element of this research paper is represented by the way we constructed the social index meant to quantify the corporate social performance.

As future research objectives, we plan, on one hand, to take into account a larger number of corporate social events and reinvestigate the same issue for different frequencies (monthly, yearly) considering data availability, and, on the other hand, to extend the analysis to various companies operating on the Romanian and Central-Eastern European business environment, in order to refine this first intent.

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Table 1: Theoretical synthesis of possible correlations between SP and FP
Sign and direction of the SP-FP relationship

Correlation	Theoretical grounds	Description
Negative	**Substitution hypothesis** (M. Friedman, 1962) *Higher SP leads to lower FP*	The hypothesis reflects Friedman's neo-classical argument considering that obtaining high profits for the shareholders should be the only social responsibility of a business. If a company increases its SP it will increase costs and reduce profitability.
	Managerial opportunism hypothesis (L.E. Preston and D.P. O'Bannon, 1997) *Higher FP leads to lower SP*	This hypothesis assumes that increased FP will motivate managers to reduce SP costs and maximize personal gains.
	Negative synergy (L.E. Preston and D.P. O'Bannon, 1997) *Lower SP leads to higher FP* *Higher FP leads to lower SP*	The theory links the *substitution* and *managerial opportunism* hypotheses in a simultaneous codetermi-nation relationship.
No correlation	**Supply and demand theory of the firm** (A. McWilliams and D. Siegel, 2001) *No link between SP and FP*	The theory states the existence of an "ideal" SP level for each company that managers can determine through a cost-benefit analysis, and the lack of correlation is explained by the fact that a company will offer the exact SP needed to maximize profits.
Positive	**Social impact hypothesis** (B. Cornell and A.C. Shapiro, 1987) *Higher SP leads to higher FP*	The hypothesis reflects the theory of stakeholder rights, stating that taking into account the interests of all stakeholder groups will increase FP. If a company does not answer also to the less explicit stakeholder needs, it could experiment failures in the market (e.g. losing corporate reputation), which will increase the risk level and decrease FP. SP costs are minimal compared to potential benefits.
	Available funds hypothesis (S.A. Waddock and S.B. Graves, 1997) *Higher FP leads to higher SP*	The hypothesis states that superior FP allows a company to allocate more resources to SP. It is assumed that higher profitability allows more social respon-sibility.
	Positive synergy: The "virtuous circle" (S.A. Waddock and S.B. Graves, 1997) *Higher SP leads to higher FP* *Higher FP leads to higher SP*	The "virtuous circle" theory simultaneously considers the *available funds hypothesis* and the *social impact hypothesis*. A well-managed business organization will enjoy both higher SP and FP.

From: Salzmann, Ionescu – Somers and Steger (2005, p. 29) / Preston and O'Bannon (1997, p. 422)

Table 2: Criteria for measuring CSR of BRD

Criteria	Assigned value
A. Community	**40%**
▪ Charitable giving	25%
▪ Support for art & education	25%
▪ Volunteer programs	20%
▪ Environment protection	25%
▪ Controversial issues involvement	5%
B. Diversity	**10%**
▪ Support for disabled	30%
▪ Women contracting	40%
▪ Minority contracting	30%
C. Employee Relations	**40%**
▪ Health & safety at work	20%
▪ Work & life benefits	70%
▪ Union relations	10%
D. Reporting	**10%**
▪ Transparency	60%
▪ Standards compliance	30%
▪ Compliance with public policy	10%
TOTAL	**100%**

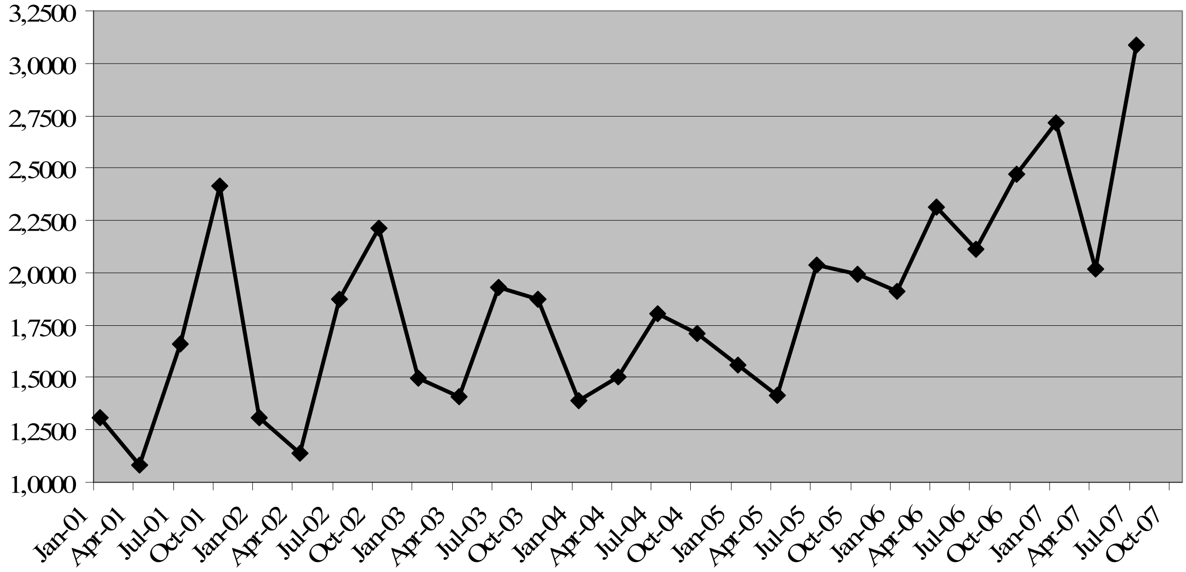
Table 3: BRD's social and financial performance

Date	SINDEX_BRD_2	RAND_BRD
iul.01	0,7250	0,2025
oct.01	0,8050	0,2238
ian.02	0,1790	0,1213
apr.02	-1,8615	0,2929
iul.02	0,9380	0,1716
oct.02	0,9025	0,2735
ian.03	-0,3955	0,1333
apr.03	-1,0585	0,1474
iul.03	0,6295	-0,1243
oct.03	0,6165	0,0452
ian.04	-0,5860	0,1918
apr.04	-0,4230	0,1577
iul.04	0,5935	0,0476
oct.04	0,1900	-0,0037
ian.05	-0,3952	0,3430
apr.05	-0,0556	0,1720
iul.05	0,0008	0,1667
oct.05	0,7690	0,0769
ian.06	-0,6645	0,1333
apr.06	-0,0330	0,1018
iul.06	0,4745	-0,0309
oct.06	-0,5945	0,1518
ian.07	0,5530	0,0354
apr.07	-0,1105	0,0616
iul.07	-0,9406	0,2437
oct.07	1,7602	-0,0649

Table 4: Pairwise Granger Causality Tests at 2 lags

Null Hypothesis:	Obs	F-Statistic	Probability
SINDEX_BRD_2 does not Granger Cause RAND_BRD	24	2.48794	0.10972
RAND_BRD does not Granger Cause SINDEX_BRD_2	24	2.83124	0.08391

Graph 1: SINDEX



Graph 2: BRD's price evolution